United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-2614
74-2657
75-7010

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P/S

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

GEON INDUSTRIES, INC., et al.,

GEON INDUSTRIES, INC., and
GEORGE O. NEUWIRTH,

Defendants-Appellants,

FRANK BLOOM and EDWARDS & HANLY,

Defendants-Appellees.

On Appeal from the United States District
Court for the Southern District of New York

ANSWERING BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

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INDEX

CITATIONS

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COUNTERSTATEMENT OF THE ISSUES ON APPEAL PERTINENT TO GEORGE NEUWIRTH AND GEON INDUSTRIES, INC.

1. Does the record support findings, upon which the chief executive officer of a corporation was enjoined from future violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5, that information about the corporation that was not other-

wise publicly available, and which a reasonable investor would have utilized in making a decision to buy, sell or hold the corporation's securities, was repeatedly divulged by the corporate official to a close friend and to a securities salesman and used by them in their trading in the corporation's securities?

2. Should a corporation be enjoined from future violations of the federal securities laws based upon (a) the disclosures of its chief executive officer described above, (b) the false statements of its financial vice-president, who also served as its controller, treasurer and secretary, to a representative of the American Stock Exchange concerning a possible adverse material change in the status of a proposed merger that would have otherwise raised the price of the corporation's stock, which false statements induced the Exchange to permit trading in the stock to commence, even though this corporate officer had reason to suspect that persons aware of the nonpublic facts might be seeking to unload their stock, or (c) a direction to his stock broker by a key employee in the middle of the night to sell all his stock in the corporation directly after the employee in the course of his duties had learned of the possible existence of facts that, if verified, would prevent a previously announced merger -- and which direction motivated the broker to make additional sales on behalf of his other customers and his wife?

COUNTERSTATEMENT OF THE CASES

Preliminary Statement

Three appeals have been taken from an order of the United States District Court for the Southern District of New York, per Bonsal, J., entered on October 15, 1974, Nos. 74-2614, 74-2657, and 75-7010. Pursuant to a consolidated briefing schedule created by Civil Appeal Scheduling Order No. 3, as amended, the Commission filed its brief as appellant in No. 75-7010 on March 24, 1975. The instant brief answers the brief submitted on behalf of appellants Geon Industries, Inc. ("Geon") (No. 74-2657) and George O. Neuwirth (No. 74-2614). The Commission is simultaneously filing a reply brief to the answering brief of Frank Bloom and Edwards & Hanly (No. 75-7010).

For the convenience of the Court the Commission in its opening brief submitted a detailed statement of facts that is applicable to each of the three appeals and is incorporated herein by reference.[1/] There follows a summary of certain of these facts, together with additional facts required to correct misimpressions that might result from the brief of appellants Geon and Neuwirth.

Statement of the Facts

In the summer of 1973, Geon Industries, Inc. commenced preliminary discussions with Burmah Oil Co., Ltd., concerning a possible merger

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1/ Brief of the Securities and Exchange Commission filed on March 24, 1975, pp. 5-28 (hereinafter sometimes cited as SEC Brief). The abbreviations used herein are the same as those employed in that brief. See SEC Brief 6 n.2.

between the two companies (SEC Brief 9).[2/] Thereafter, Burmah requested five-year pro forma income and balance sheet estimates, an accompanying cash flow projection and a management forecast on the future of the industry in which Geon was engaged (SEC Brief 9). Also, by late August or early September, 1973, in order to keep their negotiations confidential, code names had been adopted with Geon referring to Burmah as "Max" and Burmah identifying Geon as "Banker" (II. 195-196). In October 1973 Burmah "said that they were interested in really taking a look at Geon" (II. 34) and wanted to find out "if the company [Geon] was interested in them [Burmah]" (II. 34-35). George Neuwirth, Geon's chief executive officer (II. 175), had planned to attend an auto show in London later that month, and, apparently in response to Burmah's overture, he, joined by two other Geon officers--Peter Neuwirth and Frank Bloom--went to Burmah's headquarters in Swinden, England, to "find out just what kind of company they [Burmah] were" (II. 35).

Although Geon did not publicly disclose its "preliminary discussions looking to the possible acquisition of Geon by Burmah" until December 3, 1973 (SEC Exhibit 1, I. 75a), George Neuwirth, just before traveling to England in October 1973, testified that he disclosed to a long-time friend and business associate, Roy Alpert, and others (II. 216) that he was "going [to England] for the auto show, and perhaps looking at some people in view of a merger" (II. 215). With respect to that disclosure, Mr. Alpert testified that "during a social evening Mr.

2/ Geon had been interested in locating another company with which it could merge for some time and in July 1973 had retained Drexel-Burnham & Co., a registered broker-dealer, to arrange for discussions concerning a possible merger with Burmah (II. 177-182; SEC Exhibit 11).

Neuwirth had mentioned something to the effect that there was an acquisition or sale taking place in his business," and "that they were in the process of being acquired" (III. 322, 342). Mr. Alpert then purchased approximately 2,600 shares of Geon's common stock (III. 322)--his first purchase of Geon stock since 1969, when he had acquired 250 shares at the time Geon's securities were first publicly offered (III. 320-321). Mr. Alpert also disseminated the information he received from Mr. Neuwirth to his brothers, who purchased Geon's common stock (III. 325-326). Mr. Alpert testified that at least "one of the reasons" for his purchase was Mr. Neuwirth's disclosure (III. 323, 341-343).

While at Burmah's headquarters in Swindon, Geon's officers had a two and one-half hour meeting with Burmah's "chief financial man" (II. 37) and subsequently met with Peter Simonis, "a top executive of Burmah" (II. 38-40; III. 222). They also met the managing director of a wholly-owned Burmah subsidiary (II. 39). In their meeting with Mr. Simonis and other Burmah executives, Geon's officers "expressed to them openly that we [Geon] were interested in seeing something about Burmah" (II. 38). Accordingly, Mr. Simonis "explained to [Geon's officers] somewhat about the evolution of the company" and described how "the character of the company had changed considerably over . . . the preceding five years" (II. 38).

Near the conclusion of their meeting, Burmah's executives "indicated that they were interested in Geon based upon the preliminary information they had seen" (II. 39-40) and, therefore, "would like to send people out from their operating divisions and actually take a look at the company from

the inside, meet management people, meet middle management people" (II. 40). Thereafter, Burmah sent two representatives to the United States (II. 40), who toured Geon's west coast facilities (II. 42), and Burmah instructed its accountants "to review the work papers [of Geon] from a prior year" (II. 43).

Following his return from England, Mr. Neuwirth had a series of conversations about Geon with a local securities salesman, defendant Marvin Rauch, who Mr. Neuwirth knew was "actively engaged in selling Geon stock" (III. 235), [3] and with whom Mr. Neuwirth had spoken just prior to his trip to England (III. 219-220). These conversations were followed by purchases of Geon stock by Mr. Rauch for his customers and his wife (SEC Brief 11-12).

By late November, 1973, there were public rumors "that a company was looking at Geon," and the market in Geon's stock had begun to behave "very unusually" (II. 51; III. 390). In addition, on Friday, November 30, 1973, Geon's "stock was active and up," but there "was no recent news to account for the activity" (III. 390). For these reasons, the American Stock Exchange asked Mr. Bloom whether there were any unusual corporate activities, and, upon learning of Geon's discussions with Burmah, the exchange informed Geon that a public announcement was advisable (II. 51-52; III. 390). [4]

3/ No other "broker" called Mr. Neuwirth during this period (III. 261).

4/ See page 15, n.16, of our reply brief.

Accordingly, before the commencement of trading on Monday, December 3, Geon announced that it was engaged in "preliminary" merger negotiations with Burmah (SEC Exhibit 1, I 75a). Thereafter, Geon and Burmah negotiated a $36,000,000 purchase agreement that was approved by Geon's board of directors "in principle," and an announcement to that effect was issued (SEC Exhibit 3, I. 77a). While the foregoing negotiations were in progress, Mr. Rauch continued to purchase Geon's common stock (SEC Brief 13-14).

In January 1974, representatives of Geon and Burmah prepared a succession of draft purchase agreements (SEC Brief 15). Finally, in mid-February, a proposed purchase agreement was negotiated, and Geon called a board of directors meeting for February 21, 1975--which was not publicly disclosed (SEC Brief 15). Mr. Neuwirth, however, dined with Mr. Alpert on February 20, 1974 (SEC Brief 16) and disclosed to him that Geon's board of directors was going to meet the following day (III. 331) to "rubber stamp an agreement" (III. 282, 331), leaving Mr. Alpert with an assumption, as he testified (III. 333), that the Burmah transaction "was such an important event that if [Mr. Neuwirth] signed the papers, if the deal was going through, I assumed that he would call me and I would congratulate him . . . ."

The following morning Mr. Bloom, Geon's financial vice president (II. 17), was informed of three possible errors in the Geon figures that had been assumed by its management: one of $314,000, another of $700,000,

and the third of $180,000 (SEC Brief 16-17). The last two figures, because of some offsets, were often jointly referred to in the trial as the possible $800,000 shortfall. Assuming, as found by the court below (I. 65a, 66a), that the $314,000 error would not independently have terminated the merger which the board of directors was to approve later that afternoon, the larger error, if verified, as Mr. Bloom testified, would result in a situation where "either the deal might be broken or we [Geon] would have to renegotiate the deal" (II. 126) because that error would "have brought the company below the minimum income requirement in the acquisition contract" (II. 118).[5/]

At the board of directors' meeting, Mr. Bloom reported on the potential accounting errors (II. 126; IV. 499-500, 540-541), and, as Mr. Bloom testified, there was a discussion concerning the necessity of "keeping a watch on the market activity in Geon shares" (II. 128), since "there's always a concern with the fact that a rumor can get out and that you don't have complete confidentiality" (II. 128; IV. 550-551). Accordingly, it was agreed to keep the discussion about Geon's accounting errors "in the utmost confidence" (Bloom-Newirth Brief 10) but to monitor Geon stock "the next day for any unusual activity . . ." (II. 128; IV. 500-501).

5/ Mr. Bloom testified that he initially believed the potential $800,000 earnings shortfall to be "ridiculous" (II. 151-152), but by the following morning, since he had been unsuccessful in his attempts to repudiate the preliminary reports (II. 158-159), the district court found that Mr. Bloom was merely "uncertain about the accuracy of the figures showing a possible $800,000 earnings shortfall" (I. 65a).

In order to accord Mr. Bloom an opportunity to investigate the preliminary accounting errors, the board of directors adjourned its meeting until the following Sunday (II. 127). After the board of directors' meeting, Mr. Bloom and defendant James McMahon, the controller of a wholly-owned Geon subsidiary (II. 81) who was "treated . . . as Frank Bloom's assistant" (IV. 545; II. 157), worked until after midnight in an attempt to see whether the accounting errors were substantiated (II. 129, 157). Although still incomplete, their work proved that there was a $314,000 net profit error, but the potential $800,000 shortfall remained unverified (SEC Brief 17-18). In the small hours of the morning, upon arriving home, Mr. McMahon awakened Mr. Rauch by telephoning him and instructing him to sell all Mr. McMahon's holdings in Geon as well as the Geon stock held in an account which Mr. McMahon had opened in his father-in-law's name (SEC Brief 11-12, 18).

About 9:45 that morning (III. 335), because Mr. Neuwirth had failed to telephone Mr. Alpert to tell him the merger had been approved, Mr. Alpert became "quite concerned over the fact that [he] hadn't heard from Mr. Neuwirth" (III. 334), and he and his brothers decided, therefore, to sell their holdings in Geon (SEC Brief 21-22).

At the opening of the market that morning, the American Stock Exchange had refused to permit trading in Geon stock to commence because

the "unusual amount of stock" that was to be sold at the opening (IV. 450-451) suggested that there might be undisclosed corporate developments (SEC Brief 19). Accordingly, the stock exchange telephoned Mr. Bloom and in reliance upon his representations permitted trading to commence at a time when there were outstanding orders to sell Geon stock by Messrs. McMahon, the Alperts and others, who may have been in possession of material nonpublic information (SEC Brief 19-23; SEC Reply Brief 12-13).

On Sunday, February 24, 1974, Geon's Board of Directors learned from Mr. Bloom that the preliminary reports of accounting reports were accurate and that Geon's merger with Burmah could not be carried out (II. 165-166). The following Monday Geon's officers met with representatives of the American Stock Exchange (III. 381-388), and, after disclosing the company's accounting problems, issued an announcement that "Geon's 1973 earnings would be appreciably below that on which Geon's agreement with Burmah Oil Incorporated was negotiated" (SEC Exhibit 10; I. 87a), and that the company had "requested a halt in the trading of its stock only when it learned that the stock was declining sharply" (id. at 88a).

ARGUMENT

I. THE DISTRICT COURT CORRECTLY HELD THAT GEORGE NEUWIRTH VIOLATED SECTION 10(b) AND RULE 10b-5.

A. Mr. Neuwirth Disclosed Material Nonpublic Information to Mr. Alpert.

As we have seen (SEC Brief 53), the basic test of materiality is "whether 'a reasonable man would attach importance . . . [to the fact represented] in determining his choice of action in the transaction in question,'" List v. Fashion Park, Inc., 340 F. 2d 457, 462 (C.A. 2, 1965) (bracketed material in original).[6/] Under this standard,

> "material facts include not only information disclosing the earnings . . . of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities."

Securities and Exchange Commission v. Texas Gulf Sulphur Co., supra, 401 F. 2d at 849 (emphasis added). As was held in that case, facts relating to future events become material "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company's activity," id. In Securities and Exchange Commission v. Shapiro, 494 F. 2d 1301, 1306 (C.A. 2, 1974), this Court held that whether information as to a pending merger is material depends upon whether a reasonable investor would be influenced by its disclosure.

6/ Accord: Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-154 (1972); Radiation Dynamics, Inc. v. Goldmuntz, 464 F. 2d 876, 887 (C.A. 2, 1972); Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F. 2d 833, 849 (C.A. 2), certiorari denied sub nom. Kline v. Securities and Exchange Commission, 394 U.S. 976 (1968).

Mr. Neuwirth does not contest the district court's finding that he told his close friend, Mr. Alpert, that he was going to England perhaps to look "at some people in view of a merger" (I. 59a), and that Mr. Alpert purchased 2,600 shares of Geon stock as a result of Mr. Neuwirth's disclosure (I. 59a), but he argues that his "statement made . . . to Alpert did not constitute 'material' information" (Br. 33) because Geon and Burmah had not completed their merger negotiations and, therefore, "no material facts were in existence . . ." (Br. 34, emphasis in original). But there is no requirement under the authorities noted above, that the merger must have been an absolute certainty or even highly probable.

Moreover, similar to the situation found by this Court in Shapiro, supra, 494 F. 2d at 1307, one "need not merely speculate as to how a reasonable investor might have received his information," because of the conduct of the recipient who trades directly on inside information "demonstrates empirically that the information was material." Mr. Alpert's October 15 purchase, involving about $30,000,[7/] is "the only truly objective evidence of materiality," and underscores the fact that the district court's finding that material nonpublic information was disclosed is not "clearly erroneous" under Rule 52(a) of the Federal Rules of Civil Procedure, Securities and Exchange Commission v. Shapiro, supra, 494 F. 2d at 1307; Securities and Exchange Commission v. Texas Gulf Sulphur Co., supra, 401 F. 2d at 851.

7/ The 2,600 shares were bought around October 15, 1973 (III. 322). The low market price of the stock that week was 11, the high was 13-1/4 (Edwards & Hanly Exhibit G; I. 142a). On or about the same day Mr. Alpert's brothers also purchased Geon stock (III. 325).

In any event, the likelihood of a merger between Geon and Burmah had plainly passed beyond the stage of a mere possibility. As noted above, pages 3-4, there had been extensive preliminary discussions between executives of the two companies when Mr. Neuwirth told Mr. Alpert that he was not just going to the auto show in London, but while in England he would also be discussing a possible merger (II. 215); and Mr. Alpert, while vague in his testimony, stated that he thought Mr. Neuwirth had mentioned "that they were in the process of being acquired by somebody" (III. 342). The court's finding that the information Mr. Alpert obtained at this time from Mr. Neuwirth "was one of the reasons for his decision to buy the stock" (I. 59a) is fully supported by Mr. Alpert's own admission (III. 323, 341-343). In this connection, see Securities and Exchange Commission v. Shapiro, supra, 494 F. 2d at 1307, where this Court held that it did not have to decide whether the facts in Shapiro compelled the inference drawn in the Texas Gulf Sulphur case "that purchases by persons who had never previously bought stock in the company '. . . were influenced by' the corporate secret . . .

> because the district court found that inside information had influenced appellant (citation omitted), and that finding was certainly not clearly erroneous."

The district court also found that Mr. Neuwirth "had told Roy Alpert that he could not attend his own birthday party, planned for December 17, because he was staying in New York City and was too busy with his business commitments" (I. 60a). This was the day that Geon commenced negotiations

over "the matter of money" with Burmah (III. 265), which negotiations culminated the following day in an agreement in principle that Burmah would purchase Geon for $36,000,000 (III. 268-269), the equivalent of approximately $16.80 per share (II. 69). Announcement of this figure was made by Geon on December 20 (SEC Exhibit 3, I. 77a).[8/] Roy Alpert had already purchased 1,000 shares of Geon stock on December 19, 1973, as had each of his two brothers, after Mr. Alpert "probably" told them of his conversation with Mr. Neuwirth (III. 330).

The Alperts and the George Neuwirths dined together once a week (II. 214). At one such dinner on February 20, 1974, the district court found that Mr. Neuwirth advised Mr. Alpert that "the next day the Geon Board of Directors was going to meet to 'rubber stamp' a contract with respect to the Burmah-Geon deal" (I. 60a). Although on December 20, 1973, Geon had issued a public announcement "that its Board of Directors ha[d] approved an agreement in principle with Burmah" (I. 77a), at the time of the conversation referred to there had been no public announcement as to when the board was going to meet and discuss the merger contract (III. 280). Presumably an announcement would issue as soon as the deal was "rubber stamped" (V. 848-850). But no announcement was made on February 22. And Mr. Neuwirth did not call his friend Mr. Alpert to tell him he was at least free to

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8/ That week Geon's prices ranged from a low of 9-3/8 to a high of 14-1/8 (Edwards & Hanly Exhibit G; I. 142a).

retire.[9/]

Accordingly, the district court found that Mr. Alpert and his brothers sold their Geon stock the following day because Mr. Alpert had "heard nothing fr Neuwirth" about the successful ratification of the merger agreement by Geon's board of directors (I. 60a). As we have noted, this finding is directly supported by Mr. Alpert's own testimony that he "assumed that it [the merger] was such an important event that if he signed the papers, if the deal was going through," that Mr. Neuwirth would call him so Mr. Alpert, could "congratulate" Mr. Neuwirth (III. 333). And Mr. Alpert also testified that he and his brother decided to sell half their holdings in Geon (they also sold the other half during the hour and one-half the stock was traded that morning) directly after he had told his brother that he "was quite concerned over the fact that [he] hadn't heard from Mr. Neuwirth" (III. 334).

Mr. Neuwirth argues (Br. 46, emphasis in original) that, since he did not communicate "any adverse information concerning Geon to Alpert prior to Alpert's sales of Geon stock," there is no nexus between Mr. Alpert's sales and Mr. Neuwirth's previous revelation that the merger agreement was about to be rubber stamped, and that he is immune from liability because Mr. Alpert sold, rather than purchased,

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9/ Mr. Neuwirth had become 70 on December 17, 1973, and had planned to announce on that day at a board of directors' meeting that he would "like to relinquish the responsibilities of chief executive officer" and "take a leave of absence for health reasons" (III. 311), but, "with imminent major negotiations with Burman" pending, Mr. Neuwirth testified that he "considered it unwise to change horses in midstream" (III. 311). In addition to the board of directors' meeting, a special surprise birthday party had been planned for that day, but instead Mr. Neuwirth attended "a working party" at which Geon discussed "the matter of money" with Burmah (III. 263-265).

Geon common stock. But in this instance, the lack of an official announcement and of any other communication from Mr. Neuwirth to Mr. Alpert was equivalent to a communication that something unforeseen had occurred--something of such materiality that the proposed merger had not been "rubber stamped."

The district judge's opinion states that "it is significant that the Alperts' purchases or sales all coincided with significant events in the Burmah-Geon negotiations" (I. 61a). While there may be less direct evidence to support his determination that Mr. Neuwirth violated Section 10(b) and Rule 10b-5 based on the Alperts' purchases of Geon stock on December 19, 1973, than there is to support his determinations based on the Alperts' October 15, 1973, purchases and their February 22, 1974, sales; in light of the admitted communications by Mr. Neuwirth to Roy Alpert on the latter dates and the fact that the Alperts' purchases in December were, as the district judge noted, "immediately prior to Geon's announcement of an agreement in principle with Burmah" (I. 62a), the district judge was fully justified in including among Mr. Neuwirth's violations his activities in relation to the Alperts' December 19, 1973, purchases.

B. The District Court Correctly Concluded That Mr. Neuwirth Furnished Material Nonpublic Information to Mr. Rauch.

Mr. Rauch talked with Mr. Neuwirth shortly before the latter went to England in mid-October 1973 (III. 219-220). The chart containing Mr. Rauch's transactions for himself and his clients (SEC Exhibit 17, I. 109a-116a) shows, as noted in our original brief (p. 11), six purchases within the next few days totalling 1,100 shares. When Mr. Neuwirth returned from England on October 21, as he testified, Mr. Rauch "kept on calling me

very frequently until at one time later on I had to tell him, Marvin, these telephone calls have to stop" (III. 232-233). That occurred in January, 1974 (III. 277). In the meantime, Mr. Rauch was calling so frequently that Mr. Neuwirth could not remember particular conversations or the extent to which he may have been called at his home (III. 276-277). During this period, Mr. Rauch was making purchases at least several times a week--during some periods daily (SEC Exhibit 17, 109a-113a). There were no purchases, however, in January, after Mr. Neuwirth stated that he had turned off the conversations (SEC Exhibit 17, I. 114a-115a; III. 277). Accordingly, there is ample basis for the district court's finding "that Rauch . . . had numerous opportunities for acquiring inside information" from Mr. Neuwirth (I. 67a).

II. THE INJUNCTION AGAINST GEON INDUSTRIES, INC., WAS PROPER.

A. The District Court Correctly Enjoined Geon By Reason of The Violations Committed By Mr. Neuwirth.

Having found that Mr. Neuwirth violated Section 10(b) and Rule 10b-5 (I. 62a), the district court determined that there "was no evidence that Geon had devised any procedures to prevent the misuse and illegal dissemination of material nonpublic information" and that "Geon is liable here for the violations of its chief executive officer, George Neuwirth" (I. 67a).

Geon does not contend that it should not be liable for Mr. Neuwirth's activities if he gave inside information to Mr. Rauch. Its only defense in that respect seems to be that the court below could not draw an

inference that Mr. Neuwirth gave Mr. Rauch inside information. But as we have pointed at pages 16-17, supra, the court could and did draw such an inference. The company also argues that it should not be liable for Mr. Neuwirth's tips to Mr. Alpert because they occurred in the course of social intercourse. Mr. Neuwirth, however, did not cease being the chief executive officer of Geon at 6:30 each night or at whatever time he left the office. Does Geon suggest that Mr. Neuwirth would not have been called at home had an important warehouse been destroyed by fire, if another official of the company desired to discuss an important meeting the next morning, or if misstatements about the company in the press required immediate response?

We submit that the duties of the chief executive officer of a company necessarily encompass the oversight of disclosures made by the company about its activities. The fact that a disclosure made by him at any particular time might be unlawful does not remove that activity from the course of his employment.

It is, of course, not necessary that a corporate officer make a verbal representation that he is acting on behalf of his principal before the corporation may be held liable for his misconduct. See Securities and Exchange Commission v. First Securities Co., 463 F. 2d 981, 985-986 (C.A. 7), certiorari denied sub nom. McKy v. Hochfelder, 400 U.S. 880 (1972); Restatement (Second), Agency, §§261, 262. As this Court held in Securities and Exchange Commission v. Management Dynamics, Inc., Docket No. 74-1680 (C.A. 2, March 18, 1975), Slip Op. p. 2352, "Congress evidently intended that a corporation

might be liable in some instances as a 'person;' and this can only be by virtue of agency principles, since a corporation can act only through its agents." Presumably it was because Mr. Neuwirth was chief executive officer of Geon that made the information he conveyed about Geon to his friend Roy Alpert and to the broker, Mr. Rauch, sufficiently reliable that they utilized it as a basis for when and to what extent they should trade in Geon stock.

B. Geon Should Have Been Held Liable For The Violations Of Frank Bloom.

The district court found (I. 67a) that there was no violation of Section 10(b) and Rule 10b-5 by Frank Bloom, Geon's financial vice-president, who also functions as its controller, secretary and treasurer (II. 17), when he made material misrepresentations to a representative of the American Stock Exchange which deceived the exchange into allowing trading to commence at a time when there were sell orders outstanding that were grounded upon material nonpublic information. As we point out elsewhere, this was error.[10/] Mr. Bloom is a major corporate official whose responsibilities required him to answer inquiries from stock brokers and securities exchanges and to confirm press releases (II. 51-53; III. 241-242, 368; SEC Exhibits 1, 2 and 3, 75a-77a). Geon is accountable for his misconduct, having "plac[ed] him in a position to speak for and on behalf of the corporation," cf. Kerbs v. Fall River Industries, Inc., 502 F. 2d 731, 741 (C.A. 10, 1974). See United States v. A & P Trucking Co., 358 U.S. 121, 125 (1958).

10/ SEC Brief 48-55; SEC Reply Brief 11-16.

C. Geon Should Also Have Been Held Liable for the Violation of James McMahon, One of Its Key Employees.

The district court did not base its finding of violation by Geon on the misconduct of James McMahon, the controller at Geon Intercontinental Corporation who has consented to an injunction against him. Mr. McMahon in accordance with his instructions had worked with Mr. Bloom after the board of directors meeting on February 21, 1974, in an attempt to check out the accounting discrepancies (II. 81, 157-159). Working on the books until after midnight, Mr. McMahon went home with the knowledge that Geon was faced with serious potential accounting errors (II. 129, 157). As the district court found, "later that night he [Mr. McMahon] telephoned his broker, defendant Rauch, and instructed him to sell all his Geon holdings" (I. 57a). The next morning, as found by the district court, Mr. Rauch "telephoned McMahon to confirm the sell order" (I. 57a) and shortly after that conversation "a sell order was called in from the Hewlett, Long Island office of Edwards & Hanly (where Mr. Rauch was employed) directly to the floor of the AMEX with respect to all the Geon stock in the accounts of McMahon and McMahon's father-in-law, Louis Maione" (I. 57a).[11/] This was a clear violation by Mr. McMahon. Securities and Exchange Commission v. Texas Gulf Sulphur, supra, 401 F. 2d at 852; Securities and Exchange Commission v. Shapiro, supra, 494 F. 2d at 1307.

11/ Within 10 to 15 minutes after the stock exchange permitted trading to commence in Geon stock, the manager and assistant manager of the Hewlett office of Edwards & Hanly followed Mr. Rauch's example and began to sell their Geon holdings, and Mr. Rauch placed an order to sell an additional 2,000 shares of Geon stock (SEC Brief 18, 21).

As previously noted, all persons who attended the board of directors meeting were cautioned to hold in strictest confidence the information about possible accounting errors, but there is no indication the company exercised any precaution to insure that Mr. McMahon would do so. Indeed, the district court found: "There was no evidence that Geon had devised any procedures to prevent the misuse and illegal dissemination of material non-public information" (I. 67a). Accordingly, having entrusted Mr. McMahon with such an important, confidential assignment, the company is accountable for its failure to provide adequate safeguards against his misuse of that information. Cf. United States v. A & P Trucking Co., supra, 358 U.S. at 126; Securities and Exchange Commission v. Management Dynamics, supra, Slip. Op. 2350-2354; Kerbs v. Fall River Industries, supra, 502 F. 2d at 740-741.

CONCLUSION

For the foregoing reasons, the order appealed from insofar as it enjoined George Neuwirth and Geon Industries, Inc. should be affirmed.

Respectfully submitted,

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June 1975.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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GENERAL COUNSEL

6/11

June 9, 1975

A. Daniel Fusaro, Esquire
Clerk, United States Court of
Appeals for the Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

Re: Securities and Exchange Commission v. Geon Industries, Inc.,
Civil Appeal Nos. 75-7010, 74-2657 and 74-2614

Dear Mr. Fusaro:

Enclosed for filing with the Court are 25 copies of the Commission's reply brief in No. 75-7010 as well as 25 copies of the Commission's answer to the brief of appellant, George Neuwirth (No. 74-2614) and Geon Industries, Inc. (No. 74-2657).

Pursuant to Rule 25 of the Federal Rules of Appellate Procedure, I hereby certify that two copies of each brief have been transmitted by first-class mail on this date to the following opposing counsel:

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Sincerely,

Van P. Carter
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cc: Jay G. Strum, Esq.
Evan L. Gordon, Esq.